IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

WEALTH TAX REFERENCE No 41 of 1994

For Approval and Signature:

Hon'ble MR.JUSTICE C.K.THAKKER and sd/-
MR.JUSTICE M.C.PATEL sd/-

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1. Whether Reporters of Local Papers may be allowed to see the judgements?

2. To be referred to the Reporter or not?

3. Whether Their Lordships wish to see the fair copy of the judgement?

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder?

5. Whether it is to be circulated to the Civil Judge?

1 to 5 No

COMMISSIONER OF WEALTH-TAX

Versus

SAMIR K. PATEL

Appearance:

MR.P.G.DESAI with MR MANISH R BHATT for Petitioner
SERVED BY RPAD - (N) for Respondent No. 1

CORAM : MR.JUSTICE C.K.THAKKER and
MR.JUSTICE M.C.PATEL

Date of decision: 21/07/98

ORAL JUDGEMENT (Per C.K.Thakkar,J.):

The following question is referred for opinion of this Court:-

"Whether, on the facts and in the circumstances

of the case, the Tribunal is right in law in holding that the unquoted equity shares of Limited Company should be valued on yield method under Rule 10 of the W.T.Rule, 1957?"

Though the assessee is served, nobody appears on his behalf. Mr.P.G.Desai, instructed by Mr.M.R.Bhatt, learned Counsel for the revenue, submitted that the point raised in the reference has been concluded by the Hon'ble Supreme Court in BHARAT HARI SINGHANIA AND OTHERS v. COMMISSIONER OF WEALTH-TAX AND OTHERS, 207 ITR, 1. The Hon'ble Supreme Court, after considering the relevant provisions of the Wealth Tax Act, 1957 and the Wealth Tax Rules, 1957, observed:

"The formula prescribed by rule ID for determining the market value of unquoted equity shares of a company has been set out by us hereinabove. To repeat, the formula is this: deduct all the liabilities from all the assets shown in the balance-sheet : the net amount so arrived at shall be divided by total amount of the paid-up equity share capital : the amount thus arrived at shall be multiplied by the paid-up value of each equity share ; the value so arrived at is called the break-up value of the share and 85 per cent of such break-up value shall be treated as the market value of the share. This method is, in short, called the "the break-up method". The contention of learned counsel for the assessees, S/Sri Debi Pal, M.L.Verma, Ramcahdnran, Harish Salve, G.C.Sharma and P.H. Parekh, is this : Section 7(1) of the Act contemplates rules being made for determining the market value of an asset which means the value which that asset would fetch if sold in the open market on the valuation date. The rule-making authority is to operate within the confines of section 7(1). The rules made by it should be directed towards ascertaining such market value. Rule ID, however, does not bring about the said result. It prescribes an arbitrary method, the application of which leads to an arbitrary figure unrelated to the market value of the share on the valuation date. The rule-making authority is to operate within the confines of section 7(1). The rules made by it should be directed towards ascertaining such market value. Rule ID, however, does not bring about the said result. It prescribes an arbitrary method, the application of which leads

to an arbitrary figure unrelated to the market value of the share on the valuation date. This court has repeatedly held that the proper and appropriate method for valuing the unquoted equity shares of a going concern is the yield method. The court has pointed out that the break up method is not appropriate for the purpose and that this method is adopted in exceptional situations or where the company is ripe for winding up. A method which is appropriate only in the case of a company ripe for winding up cannot be treated as a proper or appropriate method for the purpose of valuing the shares of a going concern. The formula prescribed in rule ID is unrelated to realities. The rule is thus, contrary to section 7(1) and beyond the rule making authority conferred by the Act. Even if for some reason the rule is held to be good, it should not be followed in the case of valuation of the unquoted equity shares of a company which is a going concern. In such cases, the yield method alone should be adopted. Only in the case of a company which is ripe for winding-up, its share must be valued according to the break-up method contained in the rule. In other words, rule ID is not mandatory, but directory. The majority of the High Courts in the country have taken this view and it should also be accepted by this Court."

Considering the rival submissions of the parties, the Court observed that rule ID was not ineffective or invalid for any of the reasons suggested on behalf of the assessee, nor could it be said that the Wealth Tax Officer has an option to follow or not to follow the said rule. The rule was to be followed by the Wealth Tax Officer in each and every case where. he had to value the unquoted equity shares of a company. The Court also stated:

"Explanation II in rule 1D contains two clauses. Clause (i) provides that two items shown as assets in the balance-sheet shall not be treated as assets for the purpose of rule ID. Similarly, clause (ii) says that six items shown as liabilities in the balance-sheet shall not be treated as liabilities for the purpose of rule ID. In other words, the balance-sheet of the

company with the aforesaid modifications shall be the basis for working the rule. Schedule VI to the Companies Act, as already stated, prescribes the form in which the balance-sheet of a company has to be prepared. Of the four columns provided therein, columns (2) and (3) relate to liabilities and assets. The advance tax paid under section 210 of the Income-tax Act, though already paid, is shown as an asset as required by Schedule VI. Clause (i)(a) of Explanation II, however, says that it shall not be treated as an asset. To this extent, it is in favour of the assessee because the assets as shown in the balance-sheet will stand reduced to that extent. Now, clause (ii)(e) says that in case the balance-sheet specifies any amount as "provision for taxation" in the column of liabilities, the Wealth-tax Officer shall treat only that amount as a liability which is equal to the tax payable with reference to the book profits. Any excess over the said amount shall not be treated as a liability. sub-clause (e) of clause (ii) while referring to the "amount representing provision for taxation" qualifies the said words by the words following, viz. "other than the amount referred to in clause (i)(a)." This is as it ought to be. The amount referred to in clause (i)(a) is shown in the balance sheet as an asset whereas clause (ii)(e) speaks of an amount shown as a liability in the balance-sheet. Now no company would show the amount of advance tax paid, which is shown as an asset in the column relating to assets, simultaneously as a liability in the column of liabilities. The same amount cannot be shown both as an asset as well as a liability. No auditor would be a party to the preparation of such a balance-sheet. Ordinarily, therefore, there will be no occasion for the Wealth-tax Officer to rely upon the said words "other than the amount referred to in clause (i)(a)." However, if in the case of the balance-sheet of any company, the said amount of advance tax paid is

also shown as a liability, i.e. if the said amount is included in the amount set apart as provision towards taxation, it would obviously have to be deleted from the column of liabilities-and this is also what the aforesaid words in clause (ii)(e) say. Clause (ii)(e) is in sense complementary to clause (i)(a). Truly speaking, the advance tax paid is not really an asset but the proforma of balance-sheet in Schedule VI to the Companies Act requires it to be shown as such. What clause (i)(a) does is to remove the said amount from the list of assets for the purpose of rule ID. It is then that clause (ii)(e), which speaks of liabilities, says that only that amount which is still remaining to be paid shall be treated as a liability on the valuation date. If in the provision for taxation made in the column of liabilities in the balance-sheet, the amount of advance tax already paid is again shown as a liability, it will not be treated as a liability. It must be remembered that the advance tax has already gone out of the profits and been debited in the account books of the company. This is the true function of both the sub-clauses. The situation is best explained by giving an illustration. Take a case where a company has paid Rs.8 lakhs by way of advance tax which is shown as an asset in the balance-sheet. The company has made a provision of Rs.15 lakhs for taxation which is shown as a liability in the balance-sheet. The Wealth-tax Officer estimates the tax payable on the basis of book profits at Rs.10 lakhs. What he is asked to do by clause (ii)(e) is not to treat the excess Rs.5 lakhs as a liability. The tax liability as arrived at by him is only Rs.10 lakhs, but inasmuch as Rs.8 lakhs has already been paid and only Rs.2 lakhs remains payable, the said Rs.2 lakhs alone will be treated as a liability on the valuation date. It must be remembered that Rs.8 lakhs already paid is deleted from the "assets" shown in the balance-sheet. What is shown as an asset

cannot at the same time be shown as a liability. This does not mean that tax liability is treated by the Wealth-tax Officer only as Rs.2 lakhs. It is Rs.10 lakhs. Rs.8 lakhs has already gone out of the profits and debited in the books of the company. By reading clause (i)(a) and clause (ii)(e) together, the assessee will be getting the benefit of entire Rs.10 lakhs but so afar as the balance-sheet for the purpose of rule ID is concerned, only Rs.2 lakhs will be treated as a liability on the valuation date since that is the actual amount still outstanding. We do not think that if the aforesaid clauses are understood as explained herein, there is any prejudice to the assessees or to the Revenue. It indeed reflects the true situation. It is brought to our notice that the Andhra Pradesh High Court has taken a similar view in CIT v. M.Lashmaiah (1988) 174 ITR 4 and a similar view has also been taken by the Karnataka High Court in CWT v. N. Krishnan (1986) 162 ITR 309, and the Punjab and Haryana High Court in Ashok Kumar Osmal (Minor) v. CWT (1984) 148 ITR 620. On the other hand, the Gujarat High Court in CWT v. Ashok K.Parikh (1981) 129 ITR 46 has taken a different view which has been adopted by some other High Courts. It is enough to indicate that if the said sub-clauses are understood in the manner indicated and clarified by us, counsel for the assesees agree that they have no grievance. In this view of the matter, we do not think it necessary to deal with the opposing views of the High Courts at any length."

After referring to various decisions, the Court summarised certain conclusions. Conclusions (1) and (2) read as under:

(1) ID is perfectly valid and effective. The rule has to be followed in every case where unquoted equity shares of a company (other than an investment company or a managing agency company) have to be valued. All the authorities under the Act including the Valuation Officer are

bound by the said rule. The question of the rule being mandatory or directory does not arise."

(2) While valuing the unquoted equity shares under rule ID, no deductions on account of capital gains tax which would have been payable in case the said shares were sold on the valuation date can be made. Similarly, no other deductions including provision for taxation, provident fund and gratuity are admissible. Rule ID is exhaustive on the subject."

In our opinion, the submission on behalf of the revenue that the question referred to this Court is covered by the above decision of the Apex Court is well-founded and must be accepted.

In the result, the question referred to us must be answered in negative, i.e. in favour of revenue and against the assessee. Reference is accordingly answered. In the facts and circumstances, there shall be no order as to costs.

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